KENYA

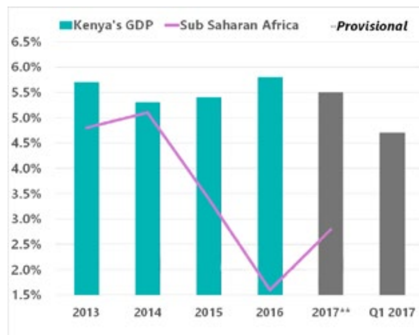
MARKET UPDATE - 1ST HALF 2017

Two Rivers Mall, Nairobi

HIGHLIGHTS

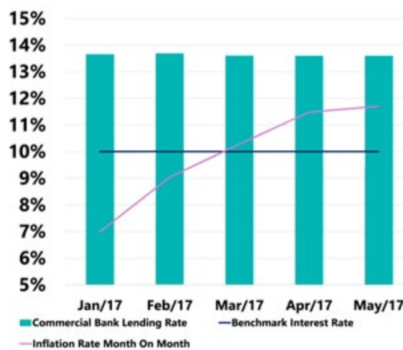
- Kenyan economy slows down
- Kenya shilling stabilises against major currencies
- Monetary Policy Committee suspends Kenya Banks Reference Rate
- Fahari I-REIT registers profits
- Prime commercial rents stagnate as supply increases
- Prime residential rents decline marginally
- International hotel brands continue to enter the market
- Shopping centre developments open for business
- Investors and developers target industrial property sector

FIGURE 1:
GDP Rates



Source: KNBS & World Bank

FIGURE 3:
Benchmark Economic Rates



Source: Central Bank of Kenya

The Economy

The Kenyan economy is estimated to have expanded by 4.7% in the first quarter of 2017 compared to 5.3% over the same period in 2016, according to the latest Kenya National Bureau of Statistics data. This decrease was largely due to weak performances by sectors such as agriculture, finance and insurance. The unfavourable weather conditions experienced from the second half of 2016 into the first half of 2017 have had severe impacts on the agricultural sector. The first quarter of 2017 saw a 62% increase in international oil prices compared to the first quarter of 2016.

Key economic sectors that contributed positively towards the first quarter's GDP included: accommodation and food services; wholesale and retail trade; real estate; transport and storage; and information and communication as well as the reduction in interest rates since the interest rate caps regime begun

Overall, GDP growth in 2017 is expected to slow down to 5.5% compared to 5.8% in 2016 as a result of the general elections in August.

The Sub-Saharan Africa GDP rate is expected to grow by 2.8% in 2017 compared to 1.6% in 2016. This is mainly attributed to the stabilisation of commodity prices and large fiscal adjustments.

The construction sector, which is traditionally a strong contributor to Kenya's GDP, experienced a slowdown in the first quarter, expanding 8.4% compared to 10.2% over the same period in 2016. The decreased growth in the sector was a consequence of significantly scaled-down activities in construction of Phase 1 of the Standard Gauge Railway (SGR) as it neared completion.

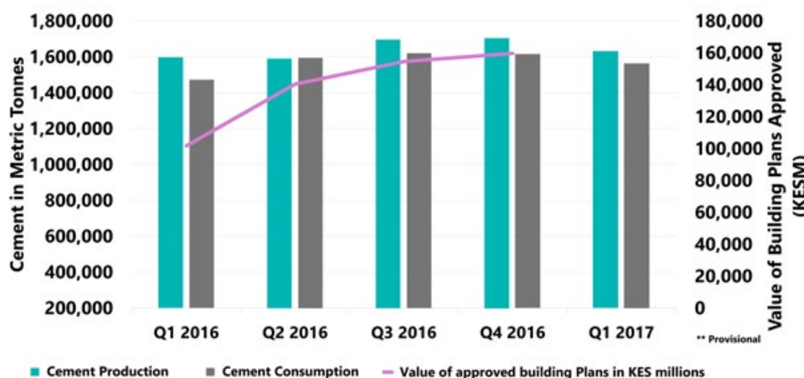
Cement production decreased slightly to 3.1 million metric tonnes (MT) in the first half of 2017, compared to 3.2 million MT in a similar period in 2016. Cement consumption increased slightly over the first five months of the year to 2.5 million MT, from 2.4 million MT in a comparable period in 2016.

The Kenya 2017/2018 National Budget Statement announced that the government would invest Kshs640.8 billion in infrastructure development, up from Kshs415.7 billion in the 2016/2017 fiscal year. The increase in investment for infrastructure development has been due to various projects, with the most notable being Kshs63.6-billion road construction projects and Kshs59.6 billion for the Phase 2A of the SGR from Nairobi to Naivasha.

The Kenyan shilling weakened against most major currencies such as the US dollar, Euro and the Sterling Pound during the first half of 2017. The Chinese Yuan, however, remained stable against the Kenyan Shilling.

The Monetary Policy Committee (MPC) announced that following the adoption of the new law capping interest rates, the Central Bank of Kenya (CBK) would suspend the Kenya Banks Reference Rate (KBRR) from January 2017. The KBRR was introduced in July 2014 to provide a transparent credit pricing framework and enhance the supply of private sector credit and mortgage finance in the Kenyan market.

FIGURE 2:
Value of Building Plans Vs Cement Consumption



Source: KNBS

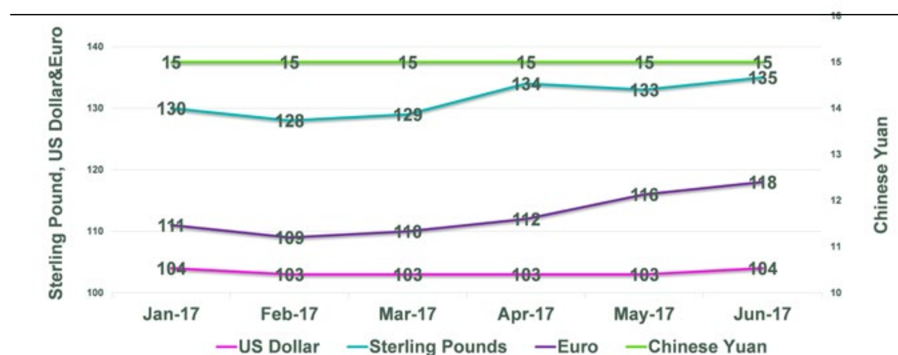
Listed Real Estate Vehicles

Listed real estate developer Home Afrika announced that revenues dipped in 2016 to Kshs222.2 million compared to Kshs259.8 million in 2015. However, the firm more than halved its losses to Kshs168.5 million from Kshs390.1 million in 2015.

The company announced plans to raise Kshs5 billion to complete infrastructure works over the next three years for various projects across Kenya. The fundraising plan will be executed through Genghis Capital Limited, targeting to raise between Kshs2 billion and Kshs5 billion from international investors. This will achieve targeted 40% equity to 60% structured debt ratio.

Similar to 2015, the Stanlib Fahari I-Reit announced plans to raise Kshs9 billion by September 2017 through a rights issue. It expects to raise funds from current and new investors for purchasing additional properties. In 2016, it generated Kshs337.6 million in revenues, registering a net profit of Ksh106 million despite a volatile Stock Exchange.

FIGURE 4:
Foreign Currency Exchange Rates



Source: Central Bank of Kenya

Fahari I-REIT's unit price remained stable until May when it decreased to Kshs10.45, before rising to Kshs12.55 in June. Fahari I-REIT closed the first half of 2017 at Kshs12.55, which was 37% lower than the initial listing price of Kshs20. Home Afrika's share price depreciated by 9.5% in the first half of 2017, closing at Kshs0.95 in June compared to Kshs1.05 in January. This was 92% lower than its initial listing price of Kshs12.

Infrastructure & Policy

Kenya National Highways Authority (KeNHA) announced plans to commence construction of Phases Two and Three of the Dongo Kundu bypass as Phase One is currently 70% complete. The project is being funded by the Japanese government through the Japan International Cooperation Agency (JICA), Trade Mark East Africa (TMEA), the World Bank and the African Development Bank (AfDB). It is expected to be completed in 2018 and upon completion the new bypass is expected to ease congestion at the Likoni channel, and transportation of cargo from the port.

The first phase of the SGR project, between Mombasa and Nairobi, was completed and will be operated by China Road and Bridge Corporation (CRBC). It was launched on 31st May 2017 and the project was financed through a US$2 billion commercial loan from the Chinese government and a US$1.6 billion semi-concessional loan. The trains consists of 40 passenger coaches with a total capacity of 118 passengers and run at an average speed of 120 kilometres per hour, which will reduce the commute time between Nairobi and Mombasa to under five hours. The journey takes over seven hours by bus and 12 hours via the metre-gauge railway. The SGR trains are expected to stopover at seven major stations during the 472-km journey.

The second phase of the SGR commenced a month after the commissioning of Phase 1. Construction of the 120-km railway line from Nairobi to Naivasha is expected to cost Kshs60 billion. The new line is expected to pass through special economic zones in Naivasha and Olkaria geothermal fields. Once completed, the second phase is expected to reduce transport costs significantly.

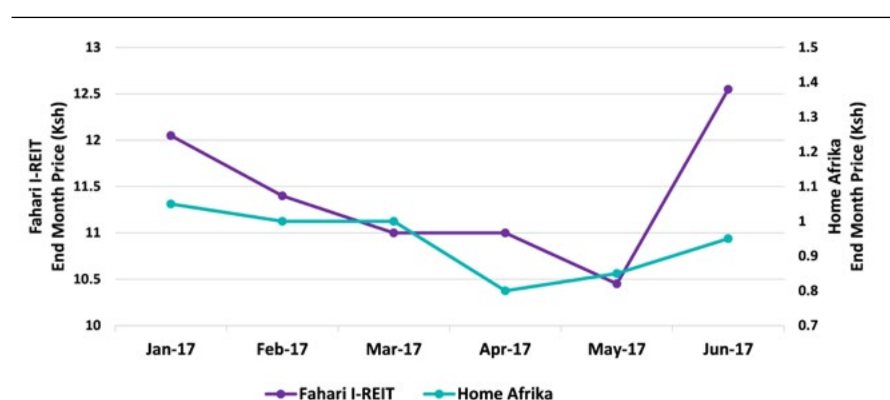
Major infrastructural projects continue to be rolled out throughout the country through Public Private Partnerships (PPPs). Construction of the Mombasa-Jomvu superhighway is expected to commence after the Kshs6.5 billion contract was awarded to the Third China Engineering Company. The 10-km superhighway will be a dual carriageway with six lanes and construction is expected to take two and half years. The highway once completed will ease transportation of cargo from Mombasa port to Nairobi and neighbouring countries such as Uganda, Rwanda and the Democratic Republic of Congo.

The government has awarded the tender for the dualling of Ngong Road from Dagoretti Corner to Karen Shopping Centre to China Qinjian International Group Limited. The 10-km project will commence in August and is expected to be completed in two years.

Kenya National Highways Authority (KeNHA) is also holding talks with America's Export-Import (Exim) Bank to finance the Kshs230 billion upgrade of the Nairobi-Mombasa highway into a dual carriageway along with two bridges. Construction will be carried out by China Railway 21st Bureau Group Company Limited.

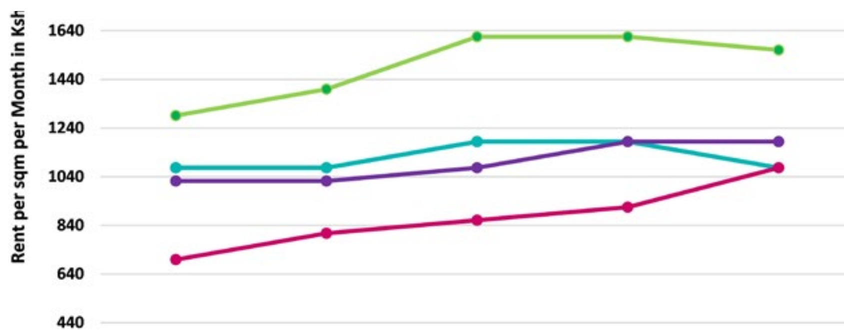
Upperhill, a major commercial office district in the capital, is currently undergoing various road expansion projects to ease the traffic congestion in that area. Whilst Phase 1 of Upperhill Road expansion is complete, Phase 2 and construction of the Upperhill-Mbagathi Link roads are currently ongoing. Both projects are expected to be completed within the second half of 2018. The government announced an allocation of Kshs1.4 billion for the

FIGURE 5:
Real Estate-Related Listings



Source: Nairobi Securities Exchange

FIGURE 7:
Average Prime Rents per Year per SqM



Source: Knight Frank Kenya

construction of 1,500 housing units for the police and prisons departments in Nairobi, and a further Kshs1.5 billion for the Civil Servants Housing Scheme Fund.

Retail

The first half of 2017 saw prime retail rents stagnate at US$55 per square metre per month (for line shops). The service charge across major retail centres in Kenya averaged Kshs430-600/sqm/month depending on management practices. The rental trend is attributed to several factors that include: increased supply coupled with major retailers having expanded simultaneously. The pressure has resulted in several trading challenges amongst retailers, including cash flow issues that have led to branch closures, slow payments to suppliers, lack of stock, and consequently, a myriad management issues that require huge amounts of investments and expertise to solve. Local supermarket chain Nakumatt, which is the anchor tenant in majority of Nairobi's malls, is currently downsizing due to liquidity problems. Consequently, the retail segment is now a tenants' market with landlords currently providing incentives to tenants such as freezing rent escalations, offering longer rent-free periods and increased fit-out contributions so as to attract and retain tenants.

The trend of stagnating rents is expected to continue into the second half of 2017.

Despite the headwinds, market players have started to adapt to the situation by carrying out more in-depth research into consumer trends in addition to adopting international rental models such as turnover rentals. Occupancy levels in well-established malls such as The Junction and Sarit Centre remain high at over 95%. Occupancy in newer malls such as The Hub is expected to rise to the levels of 90% in the second half of 2017. Demand remains strong for strategically located shopping centres and their constant focus on improving the customers' experience. Similar to the second half of 2016, new retail spaces opened in the review period, adding to competition for foot and vehicular traffic for existing malls.

Major retail completions in the first half of 2017 included Two Rivers Mall (67,000 sqm), which is East Africa's largest shopping centre development, and Rosslyn Riviera (12,000 sqm) – both of which opened for trading in February. Two Rivers, despite its size, was 67% let when opening, a level that has since risen. LC Waikiki, the Turkish clothing company with over 750 outlets worldwide, has since begun trading at Two Rivers, attracting high footfall to the mall.

Expected completions in the 2nd half of 2017 include: Ciata City Mall (6,000 sqm), Diamond Plaza II (8,361 sqm of retail space), Village Market Phase II (21,367 sqm) and Westgate with an additional 10,000 sqm. In addition, Signature Mall (20,570 sqm), at Mlolongo in Machakos County, will have the Botswana supermarket chain Choppies as its anchor tenant. Rupa Mall in Eldoret (13,935 sqm) will have Chandarana as the anchor tenant. Retail developments currently in the pipeline include: KWH Hub (10,766 sqm) in Nakuru, Southfield Mall in Embakasi (13,935 sqm), Waterfront in Karen (19,509 sqm) and Crystal Rivers in Athi River (18,766 sqm).

Britam has announced plans to build a Kshs12 billion mixed-use development in Kileleshwa that will incorporate a shopping mall (13,500 sqm), offices, serviced apartments and a hotel. It will aim to cater to the Kileleshwa market that currently doesn't have a similar development in the area. The proposed project will be undertaken by Britam Properties, a subsidiary of Britam Holdings Limited.

With circa 200,000 sqm of retail space expected in the capital in 2017, shopper cannibalisation and slower uptake of new space are expected to remain a constant feature of the changing retail landscape.

Office

Nairobi experienced a 2% decline in the absorption of office space in the first half of 2017 compared to the second half of 2016. This excludes owner occupied properties which if included would have seen an overall positive impact on absorption.

Riverside recorded the highest take-up in the period, accounting for 31% of the space let, followed by Westlands, Kilimani and Upperhill.

Prime asking rents remained stable at US$1.4/sqft/month in the first half of 2017. However, downward pressure on rentals is expected in the near future as result of several factors that include: oversupply within the market specifically certain locations like Upperhill; downsizing by multinationals, which mainly take up Grade A office space; a decline in economic growth; and hesitation by potential tenants to take up space due to the general elections.

The anticipated release of circa 240,000 sqm of office space in Nairobi in 2017, up from about 210,000 sqm in 2016, is expected to continue exerting a downward pressure on rents in the short term.

Notable completions in the first half of 2017 included Britam Towers in Upperhill with a lettable area of 30,000 sqm and Two Rivers office park with a lettable area of 28,000 sqm.

Dunhill Towers, a 20-storey office complex in Westlands, has a lettable area of 12,000 sqm and is expected to be completed in the second half of 2017. Other major pipeline developments include Eurecca Offices in Riverside, The Pinnacle in Upperhill, and One Africa Place, Sanlam Tower and The Promenade – all in Westlands, as well as the Church Commissioners for Kenya (CCK) building in Kilimani. All these developments have broken ground.

Construction of The Pinnacle by White Lotus Projects Limited commenced in May and is expected to be complete by December 2019. The Pinnacle will be Africa's tallest building at 300 metres and construction is being undertaken by China State Construction Engineering Corporation (CSCEC).

Residential

Prime residential rents in Nairobi declined over the review period albeit at a slower rate of -2.75% compared to -4.36% over the first half of 2016. The decline being experienced in the market has been occasioned by an oversupply which has given tenants more leverage to negotiate with landlords. Corporate budget cuts by multinationals have also impacted on the high-end residential market segment as the niche is dominated by expatriate tenants.

Prime residential prices decreased by 0.9% over the first half of 2017 compared to an increase of 1.3% over the same period last year. The prevailing market conditions, coupled with the already high capital values of prime residential homes, has resulted in low transaction volumes. Furthermore, the introduction of interest rate capping during the second half of 2016 led to most financial institutions being reluctant to lend to private individuals. Lenders have since shifted their focus to corporate borrowers and investing in government bonds.

This trend is expected to continue into the second half of 2017 as potential tenants and buyers hold off key investment decisions until after the general elections.

Major proposed residential developments in the pipeline include Five Star Paradise by AMS Properties in Kiambu comprising 219 residential units on a 40-acre site. The residential units will each sit on an 1/8th of an acre, with prices ranging from Ksh26 million to Ksh45 million.

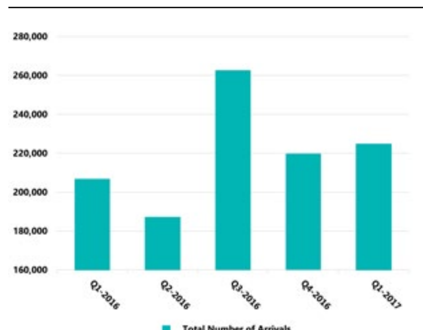
Also in Kiambu County, Tatu City has proposed a residential development called Tatu Waters. It will comprise of a total of 2,715 residential house and is estimated to cost Kshs35 billion.

In Nairobi, Britam broke ground on its 11-storey residential development in Kilimani. It sits on 1.6 acres and will consist of 163 fully furnished and serviced apartments targeting business travellers and executives. It is estimated to cost Kshs3 billion.

Hotel & Tourism

The first half of 2017 saw the opening of various international hospitality chains around Nairobi, including Lazizi Premiere Hotel by Sarovar in January 2017, Four Points by Sheraton under Marriott International in Hurlingham, and Park Inn by Radisson, under the Carlson Rezidor Hotel Group in Westlands, Nairobi. Four Points in Hurlingham took over the Best Western Hotels & Resorts brand.

FIGURE 8:
Quarterly Arrival Trends



Source: KNBS

Tune Hotel, which opened in 2016, is currently undergoing a management change from the Malaysian hotel brand Tune Group to the French conglomerate AccorHotels. The Hotel is expected to re-launch during the second half of the year under the Ibis brand and continue targeting the budget segment of the market. The new acquisition will increase the AccorHotels Group's portfolio in Kenya, which will include the soon-to-be-completed Pullman Hotel. It will also manage the Fairmont Group portfolio which includes Fairmont Norfolk in Nairobi, Fairmont Mara Safari Club and Fairmont Mt Kenya Safari Club in Nanyuki.

The Serena Group of Hotels that trades under the name Tourism Promotion Services (TPS Serena) has received a US$20 million loan from the French fund Proparco to develop more properties and expand some of the existing facilities. Nairobi Serena Hotel is currently undergoing an expansion and the upgrade is expected to cost about Kshs2.2 billion, to be completed by April 2018.

Simba Corporation, the property holders of the Olare Mara Kempinski in Maasai Mara, Villa Rosa Kempinski in Nairobi and The Acacia Premier Hotel in Kisumu, has recently acquired a 35% shareholding in Hemingways Group. The group currently owns luxury hotels in Watamu, Nairobi and the Maasai Mara. The recent acquisition will increase Simba Corporation's portfolio in the hospitality and tourism industry.

Major hotel developments in the pipeline include City Lodge, which is part of City Lodge Hotel Group that owns Fairvew Hotel and Town Lodge, both in Nairobi; Mövenpick Hotel & Residences by Mövenpick Hotel and Resorts; and Hilton Garden Inn expected to open in October.

Marriott International is expanding its Kenyan hotel portfolio with two more hotels in Nairobi. Four Points by Sheraton is being constructed near Jomo Kenyatta International Airport well as a 365-room, 5-star JW Marriott luxury hotel at the Avic International complex in Westlands which is set to be complete in 2020.

Kenya Airways has commenced the clearing process for direct flights to the US. The US Federal Aviation Administration (FAA) awarded Jomo Kenyatta International Airport (JKIA) with 'Category One' status in February, which is a mandatory status required of any airport that is allowed to host direct flights to the United States. KQ expects to have its first direct flight to the US in the first half of 2018. Once direct flights to the US are introduced, there will be a positive impact on both the tourism and agriculture industries, as tourist numbers are expected to increase, while transport costs for agricultural exports are also anticipated to reduce.

Hotspots for hotel development remain those located along the main highways with easy accessibility and high visibility.

International tourist arrivals to Kenya are set to increase over the 1st half of 2017 compared to a similar period in 2016, further boosting the hospitality sector

Industrial Market

The first half of 2017 has seen logistic parks gaining momentum, responding to the growing demand for high quality international standard warehousing space with modern, high-specification facilities to suit varied occupiers. Currently, Nairobi's Industrial Area is congested and the facilities are outdated.

Britam announced it will build a 50,000 sqm logistic park on 25 acres in Mlolongo. The logistics centre is expected to cater for transport, warehousing and distribution for goods on national and international transit.

The Commonwealth Development Corporation (CDC) and International Finance Corporation (IFC), a member of the World Bank Group, are investing US$35 million in Africa Logistics Properties Holding (ALP), the developer and manager of modern Grade A warehousing complex under construction in Tatu City. It broke ground in June and expects to build a floor space of 50,000 sqm. CDC and IFC are investing US$25 and US$10 million respectively into the proposed project, while Mbuyu Capital Partners, an Africa-focused UK-based asset manager, is expected to invest an additional US$5 million. ALP, which is also backed by Maris, an investment holding company, is expected to invest US$8 million.

The upcoming mixed-use real estate project, Tatu City in Kiambu County, was declared a Special Economic Zone in May, which will allow manufacturers to enjoy tax concessions to encourage industrialisation. Businesses operating within this zone will be exempt from value-added tax, income tax, custom and excise duties, stamp duty and work permit quotas.

Bidco Africa announced plans in May to build 10 factories in the Tatu Industrial Park over the next five years, which it expects will generate Kshs100 billion in revenue. The development is in two phases, with the first phase expected to cost about Kshs4 billion. The second phase will have an additional investment of US$15 billion for the construction of six factories and is expected to be completed in four years.

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